BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Joint Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Issue Phase-In-Recovery Bonds and Impose, Charge and Collect Phase-In-Recovery Charges and for Tariff and Bill Format Approvals Change.	))))))))	Case No. 12-1465-EL-ATS

MEMORANDUM CONTRA FIRSTENERGY'S APPLICATION FOR REHEARING BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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I. INTRODUCTION

The Office of the Ohio Consumers' Counsel ("OCC"), on behalf of the approximately 1.9 million residential customers of the Cleveland Electric Illuminating Company, Toledo Edison, and Ohio Edison (jointly, the "Companies" or "FirstEnergy"), submits this Memorandum Contra FirstEnergy's Application for Rehearing. FirstEnergy is seeking to eliminate or diminish essential consumer protections that the PUCO adopted in its Order.[1]

On October 10, 2012, the Public Utilities Commission of Ohio ("Commission" or "PUCO") issued a Financing Order ("Order"). In the Order the PUCO set forth the authority for the Companies to issue phase-in recovery ("PIR") bonds and impose and collect from their customers phase-in recovery charges for previously authorized phase-in costs and associated carrying costs.

[1] Pursuant to Ohio Admin. Code 4901-1-12(B)(1).

FirstEnergy filed an Application for Rehearing on November 11, 2012. The Companies argue:[2] 1) the Order unreasonably and unlawfully caps all financing costs (excluding debt retirement costs) at five percent of the Companies' estimated costs, and one hundred fifteen percent for debt retirement costs;[3] 2) the Commission should not impose a cap on the interest rate (or the weighted average yield) on the PIR Bonds;[4] and 3) the Order provides for a fee for the Commission's financial advisor that is unreasonable.[56] For the reasons that follow, the Companies' Application for Rehearing should be denied, in the interest of utility customers.

II. ARGUMENT

A. It Is Reasonable And In The Best Interest Of Customers For the PUCO To Establish Caps On Financing and Debt Retirement Costs.

FirstEnergy argues that one of the main shortcomings of the Commission's Order is the "imposition of unworkable caps on financing costs (including debt retirement costs) and interest rates."[7] The Companies' further claim that [b]ecause the securitization created by the General Assembly ensures that customers will benefit from a

[2] OCC takes no position on the other assignments of error raised in the Companies' Application for Rehearing.

[3] See *In the Matter of the Joint Application of Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company for Authority to Issue Phase-In-Recovery Bonds and Impose, Charge and Collect Phase-In-Recovery Charges and for Tariff and Bill Format Approvals Change*, Case No. 12-1465-EL-ATS, Application for Rehearing at 1 (November 11, 2012).

[4] Id. at 13.

[5] Id. at 2.

[6] The Companies' Application also raises issues concerning the minimum standards for third party billing, the Commission's issuance of a supplemental financing order, the fee for a non-EDU servicer, and other errors and inconsistencies in the Financing Order.

[7] Application for Rehearing at 2.

securitization, arbitrary caps on costs are unnecessary and counterproductive."[8] This assertion is wrong, and not supported by the facts or the law.

As explained below, it is reasonable for the Commission to establish caps on individual items and the aggregate amount of financing costs associated with the issuance of a PIR bonds. The statutory requirements of a cap on total phase-in costs[9] can only be achieved through reasonable caps on all related upfront financing costs and on-going financing costs. But despite the Companies' opposition to caps on financing and debt retirement costs, ultimately FirstEnergy agrees with the caps established by the Commission[10] and only requests that certain inconsistencies within the Financing Order be corrected.[11]

1. Caps on financing costs and debt retirement costs are necessary for the protection of customers.

First, the Companies fail to support their contention that the caps established by the Commission are unworkable and unnecessary.[12] With respect to a cap on up front and ongoing financing costs, the Commission's Order states:

> …the actual financing costs (both up front and ongoing) of the PIR Bonds, excluding debt retirement costs, cannot exceed the estimated financing costs identified in the application by more than 5 percent.[13]

And with respect to debt retirement costs, the Commission held:

[8] Id. at 5.

[9] R.C. 4928.232(F).

[10] See Application for Rehearing at 7.

[11] Id.

[12] Id. at 2 and 4.

[13] Financing Order at 20 (October 10, 2012).

> the actual costs related to debt retirement cannot exceed the estimated retirement costs identified in the application by more than 15 percent.[14]

The Companies' opposition to caps on the up front and ongoing financing and debt retirement costs at this time appears to undermine the estimations of these costs provided in FirstEnergy's securitization Application. Stated differently, the Companies suggest that the estimations of up front and on-going financial costs should be ignored once the Commission approves the proposed securitization. This is wrong. By giving some extra allowance of 5% and 15% over the estimated financing costs, the Order has provided ample flexibility to accommodate possible changes in market conditions.[15]

The Companies argue that "caps are not needed"[16] and that "[t]he General Assembly understood that financing **costs necessarily will fluctuate with market conditions**…."[17] But the Companies should have provided accurate estimates as to their financing and debt retirement costs in the securitization Application. If the Companies' estimates are inaccurate or unreliable, the benefits to customers of the proposed securitization cannot be determined. And if customers will not realize cost savings from the issuance of the phase-in recovery bonds as stated in its Application, the PUCO should not permit the Companies to proceed with the securitization (and the PUCO should

[14] Id. at 20.

[15] In this regard, the Commission held "the actual financing costs (both up front and ongoing) of the PIR Bonds, excluding debt retirement costs, cannot exceed the estimated financing costs identified in the application by more than 5 percent. With respect to the issue of debt retirement costs, the Commission agrees with Applicants that these costs should be afforded more flexibility. Therefore, the actual costs related to debt retirement cannot exceed the estimated retirement costs identified in the application by more than 15 percent." Financing Order at 20.

[16] Application for Rehearing at 4.

[17] Id. at 5. (Emphasis added).

obtain and review some answers from FirstEnergy about its estimates of financing costs contained in the Application that the PUCO and others relied upon).[18]

The Companies' arguments also ignore the fact that Ohio's securitization statute specifically states that customer savings must be "measurably enhanced" [19] by the securitization, not simply that customers benefit from the securitization. Capping upfront and ongoing financing costs, as required in the Order, helps to ensure that 1) customers realize measurably enhanced savings as a result of this securitization, and 2) that the Companies' financing and debt retirement costs (for which customers will be required to pay) are not excessive. As financing and debt retirement costs will ultimately be paid by the Companies' customers, capping these costs will ensure that the benefits customers receive as a result of the securitization are measurably enhanced.

2. The statute does not prohibit caps on financing costs and debt retirement costs, and it is within the Commission's discretion to establish such caps.

The Companies' argument that "the General Assembly understood that flexibility is required in financing orders and authorized a cap only on total phase-in costs, not on financing costs"[20] and that there should not be caps on up front and ongoing financing costs is a flawed argument. Although the Ohio securitization statute does not explicitly impose caps on the upfront and ongoing financing costs of securitization, the law does not prohibit the Commission from establishing such caps. It is appropriate for the Commission, applying its technical expertise, to determine caps on financing and debt retirement costs on a case by case basis, depending upon on the facts and circumstances

[18] R.C. 4928.235(C)(2).

[19] R.C. 4928.232(D)(2).

[20] See Application for Rehearing at 4-5.

of individual utilities and proposed securitizations. Further, capping the up front and ongoing financing costs is necessary to achieve the cap on total phase-in costs, as required by the statute.

Through the enactment of R.C. Title 49, the General Assembly created a broad and comprehensive statutory scheme for regulating the business activities of public utilities, including the regulation of utility service.[21] "As part of that scheme, the legislature created the [PUCO] and empowered it with broad authority to administer and enforce the provisions of Title 49."[22] The PUCO's ordering of caps on financing and debt retirement costs is reasonable and within the Commission's discretion. In this regard, the Ohio securitization statute requires that the customers' net savings from the proposed securitization be **measurably enhanced**[23] as a result of exchanging the high-interest debt issued by the electric distribution utilities ("EDUs") with a new lower-cost debt issued by a special purpose entity ("SPE"). Capping financing and debt retirement costs is one essential way to assure that the benefits to customers are, in fact, measurably enhanced by the securitization.

B. The Interest Rate Cap on the PIR Bonds Is Reasonable, And Essential in Protecting Customers.

FirstEnergy contends that the Commission erred by imposing a cap on the interest rate for the PIR Bonds equivalent to the interest rates originally included with the Application filed in May.[24] In the Order (Section VI.B.8.), the Commission provides that "the PIR Bonds shall be issued only with fixed interest rates that are at or below those

[21] *Kazmaier Supermarket, Inc. v. Toledo Edison Co.*, 61 Ohio St.3d 147, 573 N.E.2d 655 (1991).

[22] Id.

[23] R.C. 4928.232 (D)(2). (Emphasis added).

[24] Id. at 13.

referenced in the application (i.e. a weighted average yield, exclusive of upfront and ongoing costs, of less than 3 percent) . . . ."[25] The Companies submit that fixed interest rates are appropriate, but claim that the Commission's interest rate cap is unreasonable and "jeopardizes the entire securitization and the benefits it is expected to bring to customers."[26] This is wrong.

It is reasonable and lawful for the Commission to impose interest caps on the PIR bonds that are at or below those referenced in the Application. The interest rates included in the Companies' securitization Application were not included "solely for purposes of illustration on [sic] then-current market rates," as claimed by FirstEnergy.[27] The interest rates included in the Companies' securitization Application were used, in part, to justify, or to demonstrate, that the proposed securitization (i.e. the issuance of the PIR Bonds) would measurably enhance the benefits to customers. Accordingly, the interest rate information provided in the Application should be the most reasonably accurate information available.

Further, if there is no cap on the interest rate of the PIR bonds, the Companies could present an estimate of an unreasonably low interest rate in its Application in order to justify and support the proposed securitization. Once the securitization Application is approved, the PIR bonds could potentially be issued at a much higher interest rate if there is no such a cap on interest rates. In the unlikely circumstance that a market interest rate does change significantly, then the underlying rationale for the securitization would no longer be valid (as the Companies could not prove that the securitization would result in

[25] Financing Order at 34.

[26] Application for Rehearing at 13-14.

[27] Id. at 14.

measurably enhanced benefits to customers). But this potential change in financial market condition is not a valid reason for not imposing an interest rate cap. In this regard, the cap on interest rates of the PIR bonds is an important and appropriate safeguard for the Companies' customers for any proposed securitization.

FirstEnergy suggests that "if the Commission insists on an interest rate cap, it should be no less than 200 basis points above the estimated weighted average yield provided in the Application."[28] But the Companies proposed threshold of 200 basis points above the interest rate should be rejected by the Commission. FirstEnergy failed to provide any support for the proposed threshold in its Application for Rehearing. The Companies suggests that flexibility on the interest rate of the PIR bonds is needed to account for "market conditions over which the Companies have no control."[29] This argument is without basis. As previously discussed, the establishment of an interest rate cap on the PIR bonds will serve to protect customers in the event there is a change in market conditions.

It should be noted that the Companies receive the most direct and substantial benefits from the proposed securitization. Through the issuance of the PIR bonds, the Companies can immediately receive a large sum of capital-with no risk of repayment, and the retirement of a large amount of higher-cost debts. In addition, the Companies always maintain the option to forgo a proposed securitization, even after the financing order is final.[30] The customers are not afforded these kinds of options once the Commission has

[28] Id. at 15.

[29] Application for Rehearing at 15.

[30] See R.C. 4928.235 (C)(2), which states "under a final financing order, the electric distribution utility retains sole discretion regarding whether to assign, sell, or otherwise transfer phase-in-recovery property, or to cause phase-in-recovery bonds to be issued, including the right to defer or postpone such assignment, sale, transfer, or issuance."

issued a finance order regarding a proposed securitization. Accordingly, an interest rate cap on the PIR bonds is a necessary protection for customers.

C. The Range and Disbursement of the Fee For The Independent Financial Advisor Is Not Unreasonable.

The Companies' assert that the Commission's authorized fee for its financial advisor is inappropriate and unnecessarily high.[31] The PUCO determined in the Order that the financial advisor shall be entitled to a fee "**not to exceed** $1,500,000, and $500,000 of which will be funded out of the underwriter's spread and $1,000,000 of which will be included as part of the upfront financing costs."[32] But the proposed range of the fee, disbursement of the fee out of the underwriters' spread, and the use of a competitive Request for Proposal ("RFP") process in selecting the Independent Financial Advisor are reasonable.

The Order only provides a range (with an upper cap and no lower floor) for the Independent Financial Advisor's fee. The exact amount of the fee is still to be determined through the RFP process and by the Commission. In this regard, an RFP process is often the best method available for obtaining the best pricing and will result in the best value for customers. FirstEnergy's assertion that the proposed fee and payment structure is likely to result in RFP responses that include a fee structure well above market (which the Companies do not explain) is unsubstantiated. Ultimately, the most qualified and cost efficient Independent Financial advisor will be selected by the Commission Staff, and the fee will be determined under the supervision of the Staff as a result of a competitive bidding process.

[31] Id. at 17.

[32] Financing Order at 44.

OCC proposed throughout this proceeding that the Commission hire an independent financial advisor.[33] Securitization is a specialized area for structuring and issuing bonds related to phase-in costs. Given the importance of an independent financial advisor (and the technical nature of the transaction), and the potential benefits to the utility's customers, the Commission's authorized range and disbursement of the fee for its Independent Financial Advisor is reasonable.

The Companies' main concern appears to be that the financial advisor's fee would reduce the fee paid to the financial institutions that actually conduct the transaction.[34] But the Commission's Order explains the integral role that the Independent Financial Advisor will be expected to play:

> Its role should be limited to advising the Commission or acting on behalf of the Commission regarding the **structure and pricing** of the transition bonds. The financial advisor must, however, have an integral role in the pricing, marketing and structuring of the transition bonds in order to provide competent advice to the Commission. This requires the financial advisor to participate fully in all plans and decisions related to the pricing, marketing, and structuring of the transition bonds and that it be provided timely information as necessary to fulfill its obligation to advise the Commission in a timely manner.[35] (Emphasis added).

Accordingly, and given the important responsibility of the Independent Financial Advisor for minimizing costs to consumers, paying the first $500,000 (or a lesser amount) of the Advisor's fee out of the underwriter's spread is justified and in the best interest of the customers.

In addition, the proposed range for the Independent Financial Advisor's fee should be viewed in comparison to the proposed fees for service provided to the

[33] See OCC's Initial and Reply Comments.

[34] Application for Rehearing at 18.

[35] Financing Order at 44.

Companies.[36] Specifically, in Exhibit C of the securitization Application, for the case of Multiple Utility Level Issuances, the fee for the Structuring Advisor is $900,000, the legal fees and expenses for Companies' Counsel $2,500,000, the legal fees and expenses for Underwriter's Counsel $2,150,000, and $2,436,061 for the Underwriting Costs. In an alternative approach, Single Combined Issuance, the fees for the same types of service are slightly less, but still substantial. For example, the fees and expenses for the Companies' counsel is estimated to be $2,000,000, the fees and expenses for Underwriter's Counsel $1,850,000, and the Underwriting Costs, $2,423,987. In comparison to these estimated fees for other types of professional services in a proposed securitization, the proposed range and disbursement of fees for the Independent Financial Advisor is reasonable.

Description	**Multiple Utility Level Issuances Fees**	**Single Combined Issuance Fees**
Legal Fees and Expenses for Companies' Counsel	$2,500,000	$2,000,000
Legal Fees and Expenses for Underwriter's Counsel	$2,150,000	$1,850,000
Underwriting Costs	$2,436,061	$2,423,987
Fee Independent Financial Advisor	Not to exceed $1,500,000	Not to exceed $1,500,000

Finally, the Independent Financial Advisor is of particular importance for this first securitization proceeding under Ohio law. The range for the Independent Financial Advisor's fee in this proceeding is on par with those approved by other Commissions across the country. For example, in Central Power and Light Company's Application for a Financing Order, the Public Utility Commission of Texas determined that the financial

[36] See demonstrative Table below.

advisor's fee "should be capped at an amount not to exceed $1,700,000, with $500,000 to be funded out of the underwriter's spread."[37] Further, the Public Service Commission of West Virginia approved an Independent Financial Advisor fee of $1.343 million in an Allegheny Power securitization proceeding.[38] FirstEnergy's argument in this regard should therefore be denied.

III. CONCLUSION

For the reasons set forth in this Memorandum Contra, FirstEnergy's Application for Rehearing should be denied.

Respectfully submitted,

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[37] *Central Power and Light Company Application for a Financing Order to Securitize Regulatory Assets and Other Qualified Costs*, Docket No. 21528, Financing Order at 47 (March 27, 2000). Note that the *Central Power and Light Company* proceeding was one of the first securitization proceedings in Texas, and is therefore comparable to the present proceeding with respect to the importance of an Independent Financial Advisor.

[38] *Monongahela Power Company and the Potomac Edison Company d/b/a Allegheny Power Petition for Consent and Approval for Financing and Affiliated Agreements Which Complement the Certificate Application*, Case No. 05-0750-E-PC, Commission Order at 3. September 30, 2009.

CERTIFICATE OF SERVICE

I hereby certify that a copy of this Memorandum Contra FirstEnergy's Application for Rehearing have been served via electronic transmission upon the following persons this 19th day of November, 2012.

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